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In the Supreme Court of the United States

OCTOBER TERM, 1961

VIRGINIA METAL PRODUCTS, INC., *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	4
Argument	6
Conclusion	9

CITATIONS

CASES:

Dudley, J. G., Co. v. *Commissioner*, decided February 28, 1961 (T.C.) 6
Hawaiian Trust Co. v. *United States*, 178 F. Supp. 637 7
Hawaiian Trust Co. v. *United States*, decided May 25, 1961 (C.A. 9th) 7
Koppers Co. v. *United States*, 134 F. Supp. 290, certiorari denied, 353 U.S. 983 8
Libson Shops, Inc. v. *Koehler*, 353 U.S. 382 ..... 5, 6, 7
Mill Ridge Coal Co. v. *Patterson*, 264 F. 2d 713, certiorari denied, 361 U.S. 816 8

STATUTES:

Internal Revenue Code of 1939:
Sec. 22(a) (26 U.S.C. 1952 ed., Sec. 22(a)) 5
Sec. 23 (26 U.S.C. 1952 ed., Sec. 23) 2
Sec. 45 (26 U.S.C. 1952 ed., Sec. 45) 5
Sec. 122(b) (26 U.S.C. 1952 ed., Sec. 122(b)) 2, 5
Sec. 129(a) (26 U.S.C. 1952 ed., Sec. 129(a)) 5
Sec. 129(b) (26 U.S.C. 1952 ed., Sec. 129(b)) 5

Internal Revenue Code of 1954, Sec. 382(a) (26 U.S.C. 382(a)) 8

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. 44-63) are reported at 33 T.C. 788. The opinion of the Court of Appeals (Pet. 39-42) is reported at 290 F. 2d 675.

JURISDICTION

The judgment of the Court of Appeals was entered on May 15, 1961. (Pet. 43.) The petition for a writ of certiorari was filed on August 14, 1961. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

The Winfield Construction Corporation, which was owned by two individuals, incurred net operating losses in the business of manufacturing aluminum windows and doors and selling automatic furnace stokers. Virginia Metal Products Corporation acquired the stock of Winfield and operated it for four months, at which point Winfield sold all its assets. Virginia then transferred the erection part of its steel products business to Winfield. The question is whether Winfield is entitled, under the provisions of Section 122(b)(2)(B) of the Internal Revenue Code of 1939, to set off against income from steel erection the net operating losses incurred in prior years while engaged in a different business and owned by different shareholders.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (s) [As added by Sec. 211(a), Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.
>
> (26 U.S.C. 1952 ed., Sec. 23.)
>
> SEC. 122 [As added by Sec. 211(b), Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.
>
> * * * * *
>
> (b) [As amended by Sec. 215(a), Revenue Act of 1950, c. 994, 64 Stat. 906] *Amount of Carry-Back and Carry-Over.*—
>
> * * * * *

(2) *Net operating loss carry-over.*—

* * * * *

(B) *Loss for Taxable Year Beginning After 1949.*—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for each intervening taxable year, without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1949, shall be reduced by the amount, if any, of the net income for the preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

* * * * *

(26 U.S.C. 1952 ed., Sec. 122.)

STATEMENT

The petitioner is Virginia Metal Products, Inc., formerly called Virginia Metal Products Corporation, and parent of the several corporations which filed the consolidated return involved here for the period January 1, 1952, to December 15, 1952. Prior to September 1, 1951, Virginia was engaged in the manufacture and installation of iron and steel products, specializing in library furnishings and shelving. (Pet. 46-47.)

Arlite Industries, Inc., was a corporation which resulted from a merger on April 1, 1950, of two other corporations, one of which sold and serviced automatic furnace stokers and the other of which engaged in the manufacture of aluminum storm windows and doors. (Pet. 46-47.) Arlite continued both of these businesses after the merger, but operated at a loss during the year ended December 31, 1950, and the eight-month period ended August 31, 1951. (Pet. 53.)

On September 1, 1951, the petitioner acquired all of Arlite's stock in exchange for 5,000 shares of its own $2 par value stock. (Pet. 47.) The acquisition was made for a bona fide business purpose, namely, that the petitioner wished to utilize Arlite to get into the aluminum window and aluminum partition business. (Pet. 50, 55.) This venture failed (Pet. 51-52), and on January 2, 1952, the petitioner caused Arlite to sell all of its assets and business. The petitioner retained ownership of Arlite's corporate shell, the name of which was changed to Winfield Construction Corporation. (Pet. 47, 59.)

On February 1, 1952, Virginia transferred the erection part of its steel products business, including tools and personnel, to Winfield Construction Corporation.

The separation of the erection part of the business from the rest was characteristic of the industry, and had been contemplated by Virginia for two years. Virginia then paid Winfield for carrying on the erection work formerly done by Virginia. (Pet. 52-53.)

For the period January 1, 1952, to December 15, 1952, Virginia, Winfield and another subsidiary of the petitioner called Snead, Inc., filed a consolidated return in which each of the three companies showed the following net income:

Virginia	$150,684.37
Winfield	169,131.41
Snead, Inc.	22,366.26

Winfield then deducted from its net income $153,400.60, representing a net loss carry-over from the tax year ended December 31, 1950, and the eight months ended August 31, 1951. (Pet. 53.)

The Commissioner disallowed the deduction, but the Tax Court allowed it, holding that Virginia acquired Winfield's stock for a bona fide business purpose, and not principally for the interdicted purpose (tax evasion or avoidance) mentioned in Section 129(a) of the 1939 Code (Pet. 58-59); that the loss could properly be carried over under Section 122(b)(2)(B) of the 1939 Code (Pet. 60-61); and that none of Winfield's income was properly allocable to Virginia under Sections 22(a), 45 or 129(b) of the 1939 Code (Pet. 62-63). The Commissioner appealed on the sole ground that the net operating loss could not be carried over pursuant to Section 122(b)(2)(B) of the 1939 Code as interpreted in *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382. The Court of Appeals reversed on this ground. (Pet. 39-42.)

ARGUMENT

In reversing the decision of the Tax Court, the Court of Appeals was correct. Contrary to petitioner's assertion, there is no conflict, and the Tax Court itself has now adopted the position taken by the Court of Appeals. *J. G. Dudley Co.* v. *Commissioner,* decided February 28, 1961 (1961 P-H T.C. Memorandum Decisions, par. 61,055).

The gist of petitioner's extensive argument is that *Libson Shops, Inc.* v. *Koehler,* 353 U.S. 382, is not controlling here because this is a case of a single corporate entity which is simply seeking to carry over and deduct its own losses. Petitioner refuses to recognize that in *Libson* this Court put aside the question of taxable entity and held that the carry-over privilege is not available unless there is a continuity of business enterprise. The Court pointed out that in authorizing the carry-over of net operating losses (p. 387) "Congress primarily was concerned with the fluctuating income of a single business." Its purpose was (p. 386) "to ameliorate the unduly drastic consequences of taxing income strictly on an annual basis." The carry-over provisions (p. 386) "were designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year." Congress did not intend that the carry-over provisions should be construed to give a taxpayer a windfall.

In the instant case, the Winfield Construction Corporation (previously called Arlite) incurred net operating losses while it was engaged in the businesses of manufacturing aluminum storm windows and doors and of selling automatic furnace stokers. Thereafter, on September 1, 1951, Virginia Metal Products ac-

quired all of Winfield's stock and unsuccessfully attempted to operate the businesses in which Winfield was engaged. On January 2, 1952, Virginia caused Winfield to sell all its assets and business, but retained ownership of Winfield's corporate shell. On February 1, 1952, Virginia transferred the erection part of its profitable steel products business into Winfield's corporate shell. Virginia then paid Winfield for conducting this part of the business, and Winfield made a profit. Against this profit, Winfield sought to carry over and deduct the losses which it had incurred while engaged in the stoker business and the aluminum window and door business under different ownership. This is the deduction which the Court of Appeals disallowed, pointing out (Pet. 42) that "there was no continuity of business and there was no continuity of ownership." It is obvious that the deduction would result in nothing but the windfall which this Court said was not intended by the loss carry-over provisions.

The case of *Hawaiian Trust Co.* v. *United States* (C.A. 9th), decided May 25, 1961 (7 A.F.T.R. 2d 1553), is not in conflict with the instant decision. In that case, the loss sought to be carried over was incurred in 1950 by a corporation named Hilo Gas *after* its acquisition by and affiliation with Pacific Refiners, Ltd. (Pet. 73.)[1] This loss was then carried forward on a consolidated return. In the instant case, the loss was incurred by Winfield *prior* to its acquisition by and affiliation with Virginia Metal Products. The distinction between losses occurring before affiliation and

[1] While the opinion of the Court of Appeals does not show that a consolidated return was filed in the year of loss, this was a stipulated fact, and the opinion of the District Court so states. 178 F. Supp. 637, 641.

those occurring after is crucial. In disallowing the deduction in *Libson Shops,* this Court noted that the several corporations which merged there did not file consolidated returns during the years in which the losses occurred, and it distinguished the case of *Koppers Co.* v. *United States,* 134 F. Supp. 290 (C. Cls.), certiorari denied, 353 U.S. 983, where the deduction was allowed, pointing out that the merged corporations in *Koppers* had filed consolidated returns prior to the merger.

The remaining appellate decisions with which petitioner asserts a conflict are either distinguishable on their face or actually tend to support the decision here. The nearest on its facts is *Mill Ridge Coal Co.* v. *Patterson,* 264 F. 2d 713 (C.A. 5th), certiorari denied, 361 U.S. 816, in which the court disallowed a loss carry-over to a single corporate entity on two independent grounds: (1) its acquisition by new owners for the principal purpose of avoiding taxes, in violation of Section 129 of the 1939 Code and Section 269 of the 1954 Code, and (2) the lack of continuity of business enterprise. Only the latter ground for disallowance exists here, but this is sufficient. As this Court said in *Libson Shops,* the absence of a tax-avoidance motive does not automatically justify a carry-over. Therefore petitioner's entire discussion of cases concerned only with that issue is irrelevant.

We note finally that the petitioner greatly overstates the importance of the issue presented by this case, which arises under the 1939 Code. The carry-over provisions have been substantially changed in the 1954 Code, and Section 382(a) now constitutes a specific bar to the type of deduction petitioner claims.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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